HARMONY COMMUNITY SCHOOL
HAMILTON COUNTY

REGULAR AUDIT

FOR THE YEAR ENDED JUNE 30, 2003

Auditor of State
Betty Montgomery

HARMONY COMMUNITY SCHOOL
HAMILTON COUNTY

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Auditor of State
Betty Montgomery

INDEPENDENT ACCOUNTANTS' REPORT

Harmony Community School
Hamilton County
1580 Summit Road
Cincinnati, Ohio 45237

To the Board of Education:

We have audited the accompanying balance sheet of the Harmony Community School, Hamilton County, Ohio (the School), as of June 30, 2003, and the related Statement of Revenues, Expenses, and Changes in Retained Earnings, and the Statement of Cash Flows for the year then ended. These financial statements are the responsibility of the School's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Harmony Community School, Hamilton County, Ohio, as of June 30, 2003, and the results of its operations and cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 26, 2005, on our consideration of the School's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Betty Montgomery

Betty Montgomery
Auditor of State

January 26, 2005

Corporate Centre of Blue Ash / 11117 Kenwood Rd. / Blue Ash, OH 45242
Telephone: (513) 361-8550 (800) 368-7419 Fax: (513) 361-8577
www.auditor.state.oh.us

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HARMONY COMMUNITY SCHOOL
HAMILTON COUNTY

BALANCE SHEET
AS OF JUNE 30, 2003

Assets	
Cash	$ 330,583
Prepaid Items	21,641
Total Current Assets	352,225
Noncurrent Assets	
Building, Furniture, and Equipment (Net of accumulated depreciation)	3,039,730
Total Noncurrent Assets	3,039,730
Total Assets	$ 3,391,955
Liabilities and Fund Equity	
Current Liabilities	
Account Payable	250,329
Accrued Payables	77,472
Accrued Wages and Benefits	17,212
Intergovernmental Payable	29,380
Short-Term Loans Payable	909
Current Portion of Mortgage Payable	63,384
Capital Lease Payable	4,700
Interest Payable	13,076
Line of Credit Payable	127,910
Total Current Liabilities	584,372
Noncurrent Liabilities	
Mortgage Payable	2,583,765
Total Noncurrent Liabilities	2,583,765
Total Liabilities	3,168,137
Fund Equity	
Retained Earnings	
Unreserved	223,818
Total Fund Equity	223,818
Total Liabilities and Fund Equity	$ 3,391,955

The accompanying notes to the financial statements are an intergral part of this statement.

HARMONY COMMUNITY SCHOOL
HAMILTON COUNTY

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN RETAINED EARNINGS
AS OF JUNE 30, 2003

Operating Revenues	
Foundation Payments	$ 3,153,621
Disadvantaged Pupil Impact Aid	20,720
State Special Education	729,947
Other Operating Revenue	126,682
Total Operating Revenues	4,030,971
Operating Expenses	
Salaries	1,920,129
Fringe Benefits	597,936
Purchased Services	542,425
Materials and Supplies	374,158
Depreciation	222,736
Other Operating Expenses	330,622
Total Operating Expenses	3,988,006
Operating Income (Loss)	42,965
Non-Operating Revenues/Expenses	
Interest Expense	(203,166)
Federal Grants	221,183
State Grants	59,112
Total Non-Operating Revenues/Expenses	77,129
Net Income (Loss)	120,094
Retained Earnings at Beginning of Year	103,724
Retained Earnings at End of Year	$ 223,818

The accompanying notes to the financial statements are an intergral part of this statement.

HARMONY COMMUNITY SCHOOL
HAMILTON COUNTY

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2003

Increase (Decrease) in Cash	
Cash Flows from Operating Activities	
Cash Received from State of Ohio	$ 3,904,289
Cash Payments to Employees for Services and their benefits	(2,474,419)
Cash Payments to Suppliers for Goods and Services	(1,137,176)
Other Operating Revenue	126,682
Net Cash Provided by Operating Activities	419,376
Cash Flows from Noncapital Financing Activities	
State and Federal Grants Received	280,295
Net Cash Provided by Noncapital Financing Activities	280,295
Cash Flows from Capital and Related Financing Activities	
Acquisition of Capital Assets	(370,937)
Mortgage Payable Payments	(52,851)
Capital Lease Payable Payments	(7,393)
Security Deposits Payments	127,045
Short Term Loan Payments	(5,040)
Line of Credit Payments	(74,000)
Net Cash Used for Capital and Related Financing Activities	(383,176)
Cash Flows from Investing Activities	
Cash used for Interest Expense	(190,090)
Net Cash Used For Investing Activities	(190,090)
Net Increase in Cash	126,405
Cash at Beginning of Year	204,178
Cash at End of Year	$ 330,583
Reconciliation of Operating Income to Net Cash Provided by Operating Activities	
Operating Income	$ 42,965
Adjustments to Reconciled Operating Income to Net Cash Provided by Operating Activities	
Depreciation	222,736
Changes in Assets and Liabilities	
Decrease in Prepaid Items	47,421
Increase in Accounts Payable	106,557
Increase in Accrued Payables	3,472
(Decrease) in Intergovernmental Payable	(4,339)
Increase in Accrued Wages	564
Total Adjustments	376,411
Net Cash Provided by Operating Activities	$ 419,376

Note: The statement of cash flows does not reflect the purchase of a building for $2,700,000 which was financed through two mortgages.

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1. DESCRIPTION OF THE SCHOOL AND REPORTING ENTITY

Harmony Community School, Hamilton County, Ohio (the School), is a nonprofit corporation established pursuant to Ohio Rev. Code Chapters 3314 and 1702 to provide an appropriate educational facility and program for all age groups and to provide instruction in courses, which meet general educational requirements compatible with and approved by the State of Ohio. The School qualifies as an exempt organization under Section 501(c)(3) of the Internal Revenue Code. The School is independent of any school district. The School may sue and be sued, acquire facilities as needed, and contract for any services necessary for the operation of the school.

The creation of the School was initially proposed to the State Board of Education, the sponsor, on June 9, 1998 for a three year contract. The State Board of Education approved the proposal and entered into a contract with the Management Cabinet of the School. By-Laws of the School were amended to allow for the creation of the Management Cabinet of Harmony Community School. Members of the Cabinet were appointed by the Corporate Board of Directors. The contract provided for the commencement of School operations on September 16, 1998. During the fiscal year ended 2002, a contract extension for two years was executed.

The fiscal operations of the School are under a seven-member Management Cabinet, which is directed by the Executive Director. This Cabinet is responsible for formulating policies regarding fiscal operations and monitoring the expenditure of funds. The Chief Financial Officer of the School directs the financial affairs of the School including accounting, and insurance and is responsible for reporting the progress of the School against those responsibilities.

Currently, one member of the Management Cabinet is the spouse of the Executive Director and two others are full-time employees of the school.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the School have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to government nonprofit organizations. The Governmental Accounting Standards Board (GASB) is accepted standard setting body for establishing governmental accounting and financial reporting principles. The School also applies Financial Accounting Standards Board (FASB) statements and interpretations issued on or before November 30, 1989, provided they do not conflict with or contradict GASB pronouncements. The more significant of the School's accounting policies are described below.

A. Basis of Presentation

Enterprise accounting is used to account for operations that are financed and operated in a manner similar to private business enterprises where the intent is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges or where it has been decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability or other purposes.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

B. Measurement Focus and Basics of Accounting

Enterprise accounting uses a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities are included on the balance sheet. Operating statements present increases (e.g., revenues) and decreases (e.g., expenses) in net total assets.

Basis of accounting refers to when revenues and expenses are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurements made.

Revenues are recognized when they are earned. Expenses are recognized when they are incurred.

C. Budgetary

Unlike other public schools located in the state of Ohio, community schools are not required to follow budgetary provisions set forth in Ohio Rev. Code Chapter 5705, unless specifically provided in the School's contract with its Sponsor. The contract between the School and its Sponsor does prescribe a budgetary process for the School.

D. Cash

All monies received by the School are accounted for by the School's Chief Financial Officer. All cash received by the Chief Financial Officer is held in a non-interest bearing central bank account. Total cash for the School is presented as "cash" on the accompanying balance sheet.

The School had no investments during the fiscal year.

E. Capital Assets and Depreciation

Capital assets are capitalized at cost (or estimated historical cost) and updated for additions and retirements during the year. Donated capital assets are recorded at their fair market value as of the dates received. The School maintains a capitalization threshold of one thousand dollars.

Improvements are capitalized. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend an asset's life are not capitalized.

Depreciation of furniture and equipment, computer software, and textbooks is computed using the straight-line method over an estimated useful life. Improvements to capital assets are depreciated over the remaining useful lives of the related capital assets.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

F. Intergovernmental Revenues

The School currently participates in the State Foundation Program, State Special Education Program and the State Disadvantaged Pupil Impact Aid (DPIA) Program. Revenues received from these programs are recognized as operating revenues in the accounting period in which all eligibility requirements have been met.

Grants and entitlements are recognized as non-operating revenues in the accounting period in which all eligibility requirements have been met.

Eligibility requirements include timing requirements, which specify the year when the resources are required to be used or the fiscal year when use is first permitted, matching requirements, in which the School must provide local resources to be used for a specified purpose, and expenditure requirements, in which the resources are provided to the School on a reimbursement basis.

The Academy also participates in other various Federal and/or State Programs through the Ohio Department of Education. Revenue received from these programs is recognized as non-operating revenue in the accounting period in which all eligibility requirements have been met.

Amounts awarded under the above named programs for the 2003 school year totaled $4,184,584.

3. CASH

At June 30, 2003, the school had a cash balance of $330,583 which is presented as cash and cash on hand in the accompanying financial statements. The bank balance of the School's deposits was $372,191 of which $100,000 was insured by the Federal Depository Insurance Corporation (FDIC) and the balance was insured by pooled collateral.

4. CAPITAL ASSETS

The School purchased the Jewish Community Center in September 2002 to serve as a permanent home for the school. The purchase included two separate long-term loans of $2,000,000 from Park National Bank and $700,000 from the Jewish Federation.

A summary of the School's capital assets at June 30, 2003:

Building	$3,000,000
Computer Hardware	199,735
Computer Software	91,992
Building Improvements	64,887
Furniture & Equipment	96,429
Textbooks	154,585
Total Fixed Assets	3,613,678
Depreciation	(573,958)
Net Fixed Assets	$3,039,730

5. RISK MANAGEMENT

A. Property and Liability

The School is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. For fiscal year 2003, the School contracted with Indiana Insurance Companies for property and general liability insurance. There is a $1,000 deductible with a one hundred percent blanket, all risk policy.

There were no significant reductions in insurance coverage from the prior year. Also, there were no settlements that exceeded insurance coverage for the past three years.

B. Workers Compensation

The School pays the State Workers Compensation System a premium for employee injury coverage. The premium is calculated by multiplying the monthly total gross payroll by a factor that is calculated by the State.

6. CAPITAL LEASE

The School leases a copier for $1,089 a month with an imputed interest rate of 6.25% for five years. The lease qualifies as a capital lease and is recorded as a fixed asset at the present value of the future minimum lease payments. The copier is depreciated by the School over the term of the lease and the capitalized value of the copier is $16,350. Insurance of the copier is the responsibility of the school.

The future minimum lease payments are as follows:

Year Ended June 30		
2004	5,462	
Less: imputed interest		(762)
Present value of net minimum lease payments		$4,700

7. DEFINED BENEFIT PENSION PLAN

A. School Employees Retirement System

The School contributes to the School Employees Retirement System of Ohio (SERS), a cost-sharing multiple employer public employee retirement system administered by the School Employees Retirement Board. SERS provides basic retirement benefits, disability, survivor, and health care benefits based on eligible service credit to members and beneficiaries. Chapter 3309 of the Ohio Revised Code establishes benefits. SERS issues a publicly available financial report that includes financial statements and required statements and required supplementary information for SERS. This report may be obtained by writing to the School Employees Retirement System, 45 North Fourth Street, Columbus, Ohio 43215-3634.

7. DEFINED BENEFIT PENSION PLAN (Continued)

Plan members are required to contribute 9 percent of their annual covered salary and the School is required to contribute at an actuarially determined rate. The current rate is 14 percent of annual covered payroll for fiscal year 2003; 8.17 percent was the portion to fund pension obligations. The contribution rates are established by SERS's Retirement Board within the rates allowed by State statute. The adequacy of the contribution rates is determined annually. The School's required contribution for pension obligations to SERS for the fiscal years ended June 30, 2003, 2002, and 2001 were $187,946, $44,365 and $73,957 respectively; 100 percent has been contributed for fiscal years 2003, 2002 and 2001. $7,349 represents the unpaid contributions for fiscal year 2003 at June 30 and is recorded as an intergovernmental payable.

B. State Teachers Retirement System

The School contributes to the State Teachers Retirement System of Ohio (STRS), a cost-sharing multiple employer public employee retirement system administered by the State Teachers Retirement Board. STRS provides basic retirement benefits, disability, survivors, and health care benefits based on eligible service credit to members and beneficiaries. Chapter 3307 of the Ohio Revised Code establishes benefits. STRS issues a publicly available financial report that includes financial statements and required supplementary information for STRS. This report may be obtained by writing to the State Teachers Retirement System, 275 East Broad Street, Columbus, Ohio 43215-3771.

Plan members are required to contribute 9.3 percent of their annual covered salary and the Academy is required to contribute 14 percent; 13 percent was the portion used to fund pension obligations. Contribution rates are established by STRS, upon recommendation of its consulting actuary, not to exceed statutory maximum rates of 10 percent for members and 14 percent for employers. The School's required contribution for pension obligations to STRS for the fiscal years ended June 30, 2003, 2002, and 2001 were $52,569, $66,453 and $62,446 respectively; 100 percent has been contributed for all fiscal years.

8. POST EMPLOYMENT BENEFITS

The School provides comprehensive health care benefits to retired teachers and their dependents through the State Teachers Retirement System (STRS), and to retired non-certified employees and their dependents through the School Employees Retirement System (SERS). Benefits include hospitalization, physicians' fees, prescription drugs, and reimbursement of monthly Medicare premiums. Benefit provisions and the obligations to contribute are established by the System based on authority granted by State statute. Both systems are on a pay-as-you-go basis.

All STRS benefit recipients and sponsored dependents are eligible for health care coverage. The STRS Board has statutory authority over how, if any, of the health care costs will be absorbed by STRS. Most benefit recipients pay a portion of the health care cost in the form of a monthly premium. By Ohio Law, the cost of coverage paid from STRS funds is included in the employer contribution rate, currently 14 percent of covered payroll. The STRS board currently allocates employer contributions equal to 1.0 percent of covered payroll to the Health Care Reserve Fund. For the School, this amount equaled $16,897 during the 2003 fiscal year.

STRS pays health care benefits from the Health Care Reserve Fund. At June 30, 2002 (the latest information available) net health care costs paid by STRS were $354,700,000 and STRS had 105,300 eligible benefit recipients.

8. POST EMPLOYMENT BENEFITS (Continued)

For SERS, coverage is made available to service retirees with ten or more fiscal years of qualifying service credit, disability and survivor benefit recipients. Members retiring on or after August 1, 1989, with less than twenty-five years of service credit must pay a portion of their premium for health care. The portion is based on years of service up to a maximum of 75 percent of the premium.

For this fiscal year, employer contributions to fund health care benefits were 5.46 percent of covered payroll. In addition SERS levies a surcharge to fund health care benefits equal to 14 percent of the difference between a minimum pay and the member's pay, prorated for partial service credit. For fiscal year 2003, the minimum pay has been established at $12,400. For the School, the amount to fund health care benefits, including surcharge, equaled $73,299 during the 2003 fiscal year.

The surcharge, added to the unallocated portion of the 14 percent employer contribution rate, provides for maintenance of the asset target level for the health care fund. The target level for the health care reserve is 150 percent of annual health care expenses. Expenses for health care at June 30, 2001 (the latest information available), were $182,946,777 and the target level was $274.4 million. At June 30, 2002, SERS had net assets available for payment of health care benefits of $335.2 million. SERS has approximately 50,000 participants currently receiving health care benefits.

9. OTHER EMPLOYEE BENEFITS

A. Insurance Benefits

The School District provides life, short and long-term disability insurance to all employees through a private carrier. Coverage is provided for all certified non-certified employees.

B. Employee Medical, Dental, and Vision Benefits

The School has contracted with a private carrier to provide employee medical/surgical benefits. The School pays 100% of the monthly premium.

10. DEBT

The School purchased the Jewish Community Center in September 2002 to serve as a permanent home for the school. The purchase included two separate long-term loans. The first loan was for $2,000,000 from Park National Bank at 8% interest over 119 months. Payments of interest and principal totaling $16,877 are made monthly, and a balloon payment for the outstanding balance at June 2012 of $1,400,780 is scheduled to be made at that time. The second loan was for $700,000 from the Jewish Federation at 8% over 240 months. Payments including principal and interest totaling $5,855 are made monthly. The notes are collateralized by all business assets of the School and a $1,000,000 guarantee from the Ohio School Facilities Commission.

During fiscal year 2002, the Treasurer entered into a line of credit with Provident Bank with a limit of $150,000 at an interest rate of 6.75 percent. As of June 30, 2003, $127,910 was borrowed against the limit. Principal and interest are immediately due and payable on demand. Monthly payments shall be equal to accrued and unpaid financial charges and are to be paid each month until the principal is paid. The line of credit is collateralized by the School's inventory, chattel paper, accounts, equipment and general intangibles, assignment of warrant payment from the State of Ohio.

10. DEBT (Continued)

Debt	Balance as of 07/01/02	Increases	Decreases	Balance as of 06/30/03
Capital Lease	$12,093	0	7,393	4,700
Short-Term Loan	5,949	0	5,040	909
Mortgage-Park National	0	2,000,000	39,407	1,960,593
Mortgage-Jewish Federation	0	700,000	13,444	686,556
Line of Credit	201,910	0	74,000	127,910
Total	$219,952	$2,700,000	$ 139,284	$2,780,668

Amortization of the above debt, including interest, is scheduled as follows:

	Park National Bank	Jewish Federation	Total
Year ending December 31:			
2004	$202,524	$70,260	$272,784
2005	202,524	70,260	272,784
2006	202,524	70,260	272,784
2007	202,524	70,260	272,784
2008	202,524	70,260	272,784
2009 – 2022	1,991,475	567,935	2,559,410
Total	$3,004,095	$919,235	$3,923,330

The line of credit is evidenced by a promissory note. Notes are statutorily limited to maturing at the end of the year unless the debt issued obligates or is collateralized by the State monies received by the School under Ohio Law.

11. STATE SCHOOL FUNDING DECISION

On December 11, 2002, the Ohio Supreme Court issued its latest opinion regarding the State's school funding plan. The decision reaffirmed earlier decisions that Ohio's current school-funding plan is unconstitutional.

The Supreme Court relinquished over the case and directed "…the Ohio General Assembly to enact a school-funding scheme that is thorough an efficient…" The School is currently unable to determine what effect, if any, this decision will have on its future State funding and its operations.

12. RELATED PARTIES

During fiscal year 2003, the husband of a cabinet member of the School was the Director of Harmony Community –Cincinnati, Inc. This Cabinet member was also employed by the School as a guidance counselor. Compensation for the Director and his wife were $81,885 and $43,865, respectively.

13. PURCHASED SERVICES

Purchased Services during fiscal year 2003 were comprised of the following:

Utilities	$171,749
Insurance	19,084
Student Development/Testing	53,655
Professional Fees	258,557
Building Lease	7,079
Transportation	32,301
Total	$542,425

14. CONTINGENCIES

A. Grants

The School received financial assistance from federal and state agencies in the form of grants. The disbursement of funds received under these programs generally requires compliance with terms and conditions, specified in the grant agreements and is subject to audit by the grantor agencies. Any disallowed claims resulting from such audits could become a liability of the School. However, in the opinion of management, any such disallowed claims will not have a material adverse effect on the overall financial position of the School at June 30, 2003.

B. Litigation

A suit was filed in Franklin County Common Pleas Court on May 14, 2001, alleging that Ohio's Community (i.e. Charter) Schools program violates the state constitution and state laws. The effect of this suit, if any, on the School is not presently determinable.

The Ohio Department of Education (Department) conducted an "enrollment review" of the student full-time equivalency attendance for the fiscal year ended June 30, 1999. The Department determined that the School had been over-paid $174,660 for foundation revenue, and deducted the overpayment from the School's fiscal year 2000 foundation revenue.

The School filed suit against the Department on December 11, 2000. The suit asserts that the Ohio Department of Education improperly conducted this review because there is no statutory basis for such a review to be performed and the review failed to count fully the fulltime equivalency attending the School. The School requested that the withheld amount be repaid to the School. The lawsuit was settled on September 2, 2004, and a payment of $45,000 was made from the Ohio Department of Education to the School in November of 2004.

15. MANAGEMENT'S PLAN REGARDING WORKING CAPITAL DEFICIENCY

As of the end of Fiscal Year 2003, the School had a deficiency in net working capital, due to outstanding current liabilities being greater than current liquid assets. Subsequent to year end, however, a successful lawsuit against the Ohio Department of Education combined with a growth in enrollment has resulted in an increase in cash flows. This along with a relative stabilization of operating expenses has allowed the Management to decrease the School's Accounts Payable and Line of Credit liabilities while not absorbing additional debt. By continuing to increase cash flows and decrease short-term debt, management plans to achieve a positive net working capital in the future.

Auditor of State
Betty Montgomery

INDEPENDENT ACCOUNTANTS' REPORT ON COMPLIANCE AND ON INTERNAL CONTROL REQUIRED BY *GOVERNMENT AUDITING STANDARDS*

Harmony Community School
Hamilton County
1580 Summit Road
Cincinnati, Ohio 45237

To the Board of Education:

We have audited the financial statements of Harmony Community School, Hamilton County, Ohio (the School), as of and for the year ended June 30, 2003, and have issued our report thereon dated January 26, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the School's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance that we must report under *Government Auditing Standards* which are described in the accompanying schedule of findings as items 2003-001 and 2003-002. We also noted certain immaterial instances of noncompliance that we have reported to the School's management in a separate letter dated January 26, 2005.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the School's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the School's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. The reportable conditions are described in the accompanying schedule of findings as items 2003-001 through 2003-003.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. We do not consider the reportable conditions listed above to be a material weakness. We also noted other matters involving the internal control over financial reporting that do not require inclusion in this report, that we have reported to management of School in a separate letter dated January 26, 2005.

This report is intended for the information and use of the management, Management Cabinet, and federal awarding agencies and pass-through entities, and is not intended to be and should not be used by anyone other than these specified parties.

Betty Montgomery

Betty Montgomery
Auditor of State

January 26, 2005

SCHEDULE OF FINDINGS
JUNE 30, 2003

FINDING NUMBER 2003-001

Noncompliance Citation/Reportable Condition

The Ohio Department of Education has oversight powers and responsibilities pursuant to Ohio Rev. Code, Section 3314.015 and 3314.02 regarding community or charter schools.

Ohio Dept. of Education Charter, Section 7, states that the following procedures must be in place to provide proper control over non-payroll disbursements:

- All expense request forms submitted as part of the Harmony Board approved budget must be approved by the School Director. A complete expenditure form is approved by the director.
- When the property is received or services performed, a receiving report is prepared, matched with the completed expenditure request form, and forwarded to bookkeeping for processing.
- Invoices and supporting documentation are stamped "Paid" upon payment.

During our test of non-payroll cash disbursements, we noted that 90% of expense request forms were not signed as evidence of the School Director's approval. Also, there were no receiving reports completed or evidence that these items were marked or stamped as "Paid." Not performing these controls is both noncompliance with the contract and increases the risk of assets being misappropriated. We recommend that all expense request forms be approved and signed by the Director. Once the goods are received or services rendered, a receiving report should be completed and attached to the invoice and expense request form. The three documents should be compared for accuracy, a check written, and the invoice marked as paid.

FINDING NUMBER 2003-002

Noncompliance Citation/Reportable Condition

The Ohio Department of Education has oversight powers and responsibilities pursuant to Ohio Rev. Code, Section 3314.015 and 3314.02 regarding community or charter schools.

Ohio Dept. of Education Charter, Section 7, states that the following procedures must be applied by the school to help establish a favorable control environment and to aid in identifying misstatements either as they occur or through the review process:

- Approval in advance by the Management Cabinet to hire all employees of the School;
- Approval should be made by the Management Cabinet for all pay rates;
- The Director should review the pay report each pay period.
- The Director (or his designee) should distribute the paychecks and each employee should sign a form saying that he/she received it.
- The processing of Payroll by an outside service organization.

FINDING NUMBER 2003-002
(Continued)

The following instances of noncompliance with the school contract with the Ohio Department of Education were noted in the system for processing payroll:

- None of the employees hired or terminated were approved by the Management Cabinet, nor was the established rate for the positions approved.
- Individual pay reports were not reviewed or approved by the Director.
- Employee checks were not distributed by the Director and signed for by the individual employees.
- For the last three pay periods during the fiscal year, payroll was processed by the Finance Department, rather than by an outside service organization.

Noncompliance Citation/Reportable Condition

These discrepancies could result in an overpayment, or unauthorized payment relating to payroll expenditures to occur because employees could be paid for time they are not authorized to work.

The following procedures should be applied to help establish a favorable control environment, to aid in identifying misstatements either as they occur or through the review process, and to comply with School contract with Ohio Department of Education:

- Approval in advance by the Management Cabinet to hire all employees of the School;
- Approval should be made by the Management Cabinet for all pay rates;
- All employees' timesheets should be approved by their supervisor;
- The Director should review the pay report each pay period.
- The Director (or his designee) should distribute the paychecks and each employee should sign a form saying that he/she received it.
- Payroll should be processed by an outside service provider.

Since the end of the fiscal year, many changes have occurred in the payroll function at the School. According to the new charter signed on June 28, 2004, all new hires, terminations, and pay raises are the responsibility of the Director rather than the Board. Also, payroll is processed by an outside accounting firm, each pay report is then examined by the School Director, and a each employee signs a confirmation form in order to receive his/her paycheck from the Director's designated distributor.

FINDING NUMBER 2003-003

Reportable Condition

Monitoring Controls

An effective monitoring control system has not been implemented to assist management in detecting material misstatements in financial or other information. The School should develop and implement a monitoring control system to reduce the risk of not detecting material misstatements.

Monitoring controls are comprised of regular management and supervisory activities established to oversee whether management's objectives are being achieved. These controls should address operational, legal compliance, and financial control objectives. Effective monitoring controls should identify unexpected results or exceptions (including significant compliance exceptions), investigate underlying causes, and take corrective action. There was no documentation in the minutes that the Board reviews financial information on a regular basis.

Monitoring controls may be in the nature of ongoing activities or separate periodic evaluation by either management or an internal audit function. They can relate to a specific transaction cycle or can be more overview in nature.

Monitoring controls should assist management in detecting material misstatements in financial or other information and can include:

- regular review of budget and actual expenditures;
- regular review of financial report summaries of sufficient detail (monthly detailed revenue and expenditure reports);
- review of key performance indicators;

Reportable Condition

- review of revenues/expenditures with independently accumulated information (budgets, past performance, etc.);
- review of unusual or significant items, long outstanding items, etc.;
- identification of unusual fluctuations;
- ensuring an adequate segregation of duties exist;
- review of monthly reconciliations, and
- approval of grants.

Beginning in January 2004, the Governing Authority of the Board began meeting twice a month, and regularly discussing and approving budgets, monthly reports, and other financial matters.

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HARMONY COMMUNITY SCHOOL
HAMILTON COUNTY

SCHEDULE OF PRIOR AUDIT FINDINGS
JUNE 30, 2003

Finding Number	Finding Summary	Fully Corrected?	Not Corrected, Partially Corrected; Significantly Different Corrective Action Taken; or Finding No Longer Valid; ***Explain***:
2002-10431-001	Finding for Recovery.	No	Partially corrected – Portion was repaid in Fiscal Years 2003 and 2004.
2002-10431-002	Material Noncompliance: Debt issue extended beyond fiscal year	Yes	
2002-10431-003	Material Noncompliance & Reportable Condition: School not current on its payments to SERS.	No	Partially corrected -- Reissued in management letter
2002-10431-004	Material Noncompliance & Reportable Condition: Failure to implement controls prescribed by charter over non-payroll disbursements.	No	Not corrected -- Reissued as Finding 2003-001.
2002-10431-005	Material Noncompliance & Reportable Condition: Failure to implement controls prescribed by charter over payroll disbursements.	No	Not corrected -- Reissued as Finding 2003-002.
2002-10431-006	Material Weakness: Lack of monitoring controls by management	No	Not corrected -- Reissued as Finding 2003-003.
2002-10431-007	Material Weakness: Lack of Reimbursement Policy	Yes	

Auditor of State
Betty Montgomery

88 East Broad Street
P.O. Box 1140
Columbus, Ohio 43216-1140

Telephone 614-466-4514
800-282-0370

Facsimile 614-466-4490

HARMONY COMMUNITY SCHOOL

HAMILTON COUNTY

CLERK'S CERTIFICATION

This is a true and correct copy of the report which is required to be filed in the Office of the Auditor of State pursuant to Section 117.26, Revised Code, and which is filed in Columbus, Ohio.

Susan Babbitt

CLERK OF THE BUREAU

CERTIFIED
FEBRUARY 17, 2005